



**POLICY: FI/PL/02**  
Issued on October 30, 2014

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# **Non-Grant Instruments**

<b>Summary</b>	This Policy (i) establishes the objectives for the use of non-grant instruments, (ii) defines non-grant instruments for the GEF, and (iii) sets forth the general principles and approaches for the use of non-grant instruments in GEF-financed projects.
<b>Approved by</b>	GEF Council
<b>Approval Date</b>	October 30, 2014
<b>Effective Date</b>	November 1, 2014
<b>Background</b>	This Policy was approved by the GEF Council at its 47 <sup>th</sup> Meeting in October 2014. It was presented to the Council as part of Council Document GEF/C.33/12, <i>GEF-6 Non-Grant Instruments Pilot and Updated Policy for Non-grant Instruments</i> . This Policy replaces and supersedes the policy statements contained in Council Document GEF/C.33/12, <i>Operational Policies and Guidance for the Use of Non-Grant Instruments</i> , approved by the Council at its 33 <sup>rd</sup> meeting in May 2008.
<b>Applicability</b>	This Policy applies to all non-grant instruments financed by projects or programs submitted and approved by the Council or the GEF CEO on or after the date of effectiveness of this Policy.
<b>Related Document</b>	<i>GEF-6 Non-Grant Instruments Pilot and Updated Policy for Non-grant Instruments</i> , Council Document GEF/C.33/12, October 10, 2014.
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<b>Key Words</b>	Non-grant, loan, equity, guarantee, reflows, concessional finance, private sector, non-grant pilot

## **I. INTRODUCTION**

1. This Policy establishes the framework for the use and management of non-grant instruments in GEF-financed projects and programs.

## **II. OBJECTIVES**

2. The purpose of this Policy is to set out the principles for the GEF, working with its partners, to facilitate appropriate use of non-grant instruments as a means to, inter alia: (a) enhance effectiveness by leveraging substantial capital for targeted investments that support GEF's objectives; (b) strengthen partnerships with the private and public sectors in recipient country governments; (c) enable the GEF to demonstrate and validate the application of innovative and flexible financial instruments in projects for broader adoption; and (d) enhance the financial sustainability of the GEF through the generation of reflows.

## **III. INDICATIVE TYPES OF NON-GRANT INSTRUMENTS**

3. A non-grant instrument in the context of the GEF is a mechanism to provide financing in a form that has the potential to generate financial returns, irrespective of whether such financial returns flow back to the GEF Trust Fund or not (see section V). Financial returns comprise funds or proceeds that are collected from the beneficiaries of projects/programs using non-grant instruments, including the original investment amount, principal, (excluding Agency fees), earnings or interest from the investment, dividends, proceeds from the sale of equity stakes, and repayment of original reserves and guarantee fees.

4. GEF projects/programs are designed with the appropriate type of non-grant instrument that best supports the goals of the project/program. The GEF Partner Agency submits projects/programs that include, but are not limited to, the following types of non-grant instruments, which are described in further detail in Annex A. The instrument names below are illustrative; the Partner Agency uses instruments and terms available under its policies and procedures:

- (a) Credit guarantee (partial/full);
- (b) Performance risk guarantee;
- (c) Structured financing;
- (d) Equity/investment fund;
- (e) Revolving equity fund;
- (f) Contingent loan;
- (g) Concessional loan; and
- (h) Revolving loan fund.

## **IV. FOCAL AREA ELIGIBILITY FOR NON-GRANT INSTRUMENTS**

5. All GEF focal areas set out in paragraph 2 of the Instrument are eligible to use non-grant instruments.

## **V. REFLOWS**

6. Reflows are the financial returns transferred to the GEF Trust Fund. For the purposes of the GEF Instrument (i) GEF financing is considered *GEF concessional finance*, if it is provided to a project/program that is expected to generate reflows to the GEF Trust Fund; and (ii) GEF financing is considered a *GEF grant* if it is provided to a project/program that is *not* expected to generate reflows to the GEF Trust Fund.

7. GEF grant finance (i) may be made available to any GEF recipient country provided that the recipient country meets the criteria under paragraph 9(a) or 9 (b) of the instrument; and (ii) may be provided by all GEF Partner Agencies in projects/programs using non-grant instruments.

8. GEF concessional finance for private sector beneficiaries may be made available to any GEF recipient country that meets the criteria under paragraph 9 (c) of the Instrument.

9. GEF concessional finance for public sector beneficiaries may be made available to any GEF recipient country that meets the criteria under paragraph 9 (c) of the Instrument, except that it may not be provided to an IDA country if that country is determined to be at a high risk of debt distress in accordance with the World Bank Debt Sustainability Framework (i.e., eligible to receive only IDA grants).

## **VI. GEF PARTNER AGENCY ELIGIBILITY TO ADMINISTER CONCESSIONAL FINANCE**

10. A GEF Partner Agency is eligible to provide GEF concessional finance, if it can demonstrate the following:

- (a) Ability to accept financial returns and transfer from the GEF Partner Agency to the GEF Trust Fund;
- (b) Ability to monitor compliance with non-grant instrument repayment terms;
- (c) Capacity to track financial returns (semester billing and receiving) not only within its normal lending operations but also for transactions across trust funds;
- (d) Commitment to transfer reflows twice a year to the GEF Trust Fund;

And, in case of concessional finance for private sector beneficiaries:

- (e) Track-record of repaid principal and financial returns from private sector beneficiaries to the GEF Partner Agency.

And, in case of concessional finance for public sector recipients:

- (f) Track-record of lending or financing arrangements with public sector recipients; and
- (g) Established relationship with the beneficiary countries' Ministry of Finance or equivalent.

## **VII. FINANCIAL TERMS FOR CONCESSIONAL FINANCE**

11. For non-grant instruments with private sector entities, the GEF Partner Agency designs and negotiates non-grant instruments to ensure minimum concessionality in order to avoid crowding-out of other sources of financing while achieving the project/program objectives.
12. For non-grant instruments with public sector beneficiaries, the GEF Partner Agency utilizes terms comparable to IDA.

## **VIII. MONITORING, REPORTING AND MANAGEMENT OF REFLows**

13. At the time of project proposal submission, the GEF Partner Agency indicates a timeline when all investments are to be completed and an indicative schedule of reflows. At the CEO Endorsement Request stage, the GEF Partner Agency specifies the non-grant instrument term and an updated schedule of reflows. The schedule and amount of reflows is consistent with the applicable terms of financing under the relevant project/program proposals approved by the Council and/or the CEO.
14. Each GEF Partner Agency is responsible for receiving and monitoring financial returns in accordance with its own financial management policies and procedures applicable to such financing activities.
15. Each GEF Partner Agency, in accordance with its own policies and procedures, seeks to recover outstanding balances, recognizing that the risk of non-payment by a beneficiary can reduce reflows. The GEF Partner Agency maintains documentary evidence of its efforts to recover outstanding balances and provides a sound audit trail for the purpose of reporting to the Council, as appropriate.
16. Pursuant to the provisions of the Financial Procedures Agreement entered into between the GEF Partner Agency and the Trustee, the following procedures apply to the management of reflows by the GEF Partner Agency to the GEF Trust Fund:
  - (a) The GEF Partner Agency receives and holds the financial returns arising out of non-grant instruments, including investment income accruing thereon, in a designated account until such financial returns are transferred to the Trustee as reflows;
  - (b) All actual reflows, including investment income as noted above, are transferred to the Trustee at least twice a year, or at a frequency agreed between the Trustee and the GEF Partner Agency;
  - (c) The GEF Partner Agency informs the Trustee about reflows, on a quarterly basis, or at another frequency as agreed between the Trustee and the GEF Partner Agency, of (i) the financial returns received during the reporting period; (ii) the date of such receipts; (iii) the project to which the returns are associated; and (iv) the total investment income earned on the balance of the account during this same reporting period;
  - (d) All reporting from the GEF Partner Agency to the Trustee is in writing; and

- (e) The GEF Partner Agency maintains supporting documentation which may be requested by the Trustee as needed.

17. The Trustee assigns all reflows received to the GEF Trust Fund.

## **IX. DEFINITIONS**

18. The terms used in this directive have the meanings set forth below:

19. **Executing Agency:** A GEF Executing Agency is an entity or agency that receives GEF funding from a GEF Partner Agency in order to execute a GEF project, or parts of a GEF project, under the supervision of a GEF Partner Agency. It may also be referred to as a “project executing agency”.

20. **GEF Agency:** Any of the 10 institutions that were entitled to request and receive GEF resources directly from the GEF Trustee for the design and implementation of GEF-financed projects and programs as of November 2010. They include the following organizations: the African Development Bank (AfDB), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the Food and Agriculture Organization of the United Nations (FAO), the Inter-American Development Bank (IADB), the International Bank for Reconstruction and Development (World Bank), the International Fund for Agricultural Development (IFAD), the United Nations Development Programme (UNDP), United Nations Environment Programme (UNEP), and the United Nations Industrial Development Organization (UNIDO).

21. **GEF Partner Agency:** Any of the entities eligible to request and receive GEF resources directly from the GEF Trustee for the design and implementation of GEF-financed projects and programs. This category includes both the ten *GEF Agencies* and *GEF Project Agencies*.

22. **GEF Project Agency:** Any of the institutions that the GEF has accredited to receive GEF resources from the GEF Trustee for the design and implementation to implement GEF-financed projects and programs apart from the ten GEF Agencies.

## **ANNEX A: DESCRIPTIONS FOR COMMON GEF NON-GRANT INSTRUMENTS**

1. This Annex updates and clarifies the GEF descriptions for non-grant instruments, which were first established in GEF Council Document GEF/C.13/Inf.05, *Engaging the Private Sector in GEF Activities*, April 22, 1999, and further explicated in Council Document GEF/C.32/07, *Use of Non-Grant Instruments in GEF Projects: Progress Report*, October 25, 2007.

2. There exist a vast variety of non-grant instruments encompassing a range of sophisticated, innovative financial instruments. For convenience, these instruments are often grouped into three main categories: (i) risk mitigation products; (ii) equity; and (iii) debt instruments. The following descriptions provide a helpful guide for the types of non-grant instruments that are likely to be used in GEF projects. Other types of non-grant instruments which may be developed through innovative approaches can also be considered for GEF projects.

### **Risk mitigation products**

#### *Credit Guarantee/Partial Credit Guarantee*

3. Credit guarantees are a commitment to reimburse a lender if the borrower fails to repay a loan. The credit guarantee balance is not invested, but held in reserve and only paid out if a borrower fails to repay.

4. In partial credit guarantees, the GEF provides a guarantee for a pre-defined portion of a commercial loan, sharing the rest of the risk of potential losses with the lender and other investors. This facilitates the availability of commercial loans and increases the attractiveness of the respective loan terms. By extending the maturity of commercial loans for projects, partial credit guarantees can provide improved cash flow during project life. However, they do not address risks that jeopardize cash flow, but rather provide an overall enhancement to the project's economics by covering general credit risk during a particular phase of the project.

#### *Performance Risk Guarantee*

5. A performance risk guarantee is like a credit guarantee, only in this case the guarantee fund is used to help compensate project partners if the project fails to deliver expected cost-savings (i.e., through energy efficiency improvements). This performance guarantee provides lowers the risk of default, encouraging local lenders to provide debt funding at attractive rates for the project.

#### *Structured Financing*

6. This is a mechanism that layers GEF funding, usually at concessional terms or in a junior position, as part of an overall investment package. The ability of the GEF funding to be junior, and therefore more risky, allows other investors to be senior, providing them with more predictable returns. In the event of a partial default, senior investors would be repaid first, with the GEF and other junior partners potentially receiving no repayments.

7. This mechanism is very close in end goal to a partial risk-sharing facility, however, in this model the GEF funds are invested, rather than held in reserve.

## **Equity**

### *Equity/Investment Fund*

8. Investment funds are for-profit, private sector, environmental funds that receive grant and/or non-grant funding from GEF. The objective is to provide commercial or quasi-commercial financing to subprojects through a fund manager, with a possible financial return on capital. Investment funds leverage GEF financing to mobilize a larger pool of commercial capital to invest in eligible projects, utilizing debt or equity instruments as appropriate.

### *Revolving Equity Fund*

9. A revolving fund establishes a mechanism that offers equity investments that are repaid to the fund as the project matures and generates income. If the project is not successful, the investment is fully or partially forgiven and not repaid. The revolving funds are designed to invest in a portfolio of projects anticipating that successful projects will enable returns to the fund, therefore allowing the fund to sustain operations well after the original GEF project may be completed.

## **Debt instruments**

### *Contingent Loan*

10. A contingent loan differs from a contingent grant in that a loan is treated as debt and therefore has a higher repayment priority than the converted grant. A grant is treated as project equity or an asset unless another arrangement is negotiated. A contingent loan is repaid on a similar schedule and with similar interest to other loans. Similar to the contingent grant, it could be forgiven if the project fails.

### *Concessional Loan*

11. A concessional loan refers to loans provided at below-market rates. These are also called “soft loans.” The availability of the concessional loan could be contingent upon participation of other commercial lenders to achieve co-financing and leveraging of non-GEF funds. Contingent or concessional loans would likely supplement (and probably be subordinate to) other project debt.

### *Revolving Loan Fund*

12. A revolving fund establishes a mechanism that offers contingent loans that are repaid to the fund as the project matures and generates income. If the project is not successful, the loan is fully or partially forgiven and not repaid. The revolving funds are designed to invest in a portfolio of projects anticipating that successful projects will enable reflow to the fund, therefore allowing the fund to sustain operations well after the original GEF project may be completed.